[redacted] 25X1

June 24, 1986

Mexico Talking Points for HPSCI briefing

Implications of the Finance Minister's Resignation

Former Finance Minister Silva Herzog's resignation last week suggests that President de la Madrid wants to reduce strains within his economic policy team, making it easier to obtain a consensus for possible stronger action on the financial front. Silva Herzog's dismissal also portends a loosening of Mexico's domestically unpopular economic austerity program.

Herzog resign

--Silva Herzog's replacement, Gustavo PETRICIOLI Iturbide, is considered to be financially conservative and a moderate on the debt issue.

Petricioli

--As a close friend and advisor to President de la Madrid, he is likely to follow closely the President's directives.

[redacted] de la Madrid has decided to take radical action to resolve the debt problems if an agreement with the IMF is not reached by the end of June [redacted]: 25X1 25X1

--Negotiations are continuing, but earlier this month senior Mexican economic officials and politicians were agreed that the government would reject any IMF demands for significant new budget cuts this year.

IMF

--Officials are determined instead to persuade the Fund to stretch out the timetable for a new agreement through the end of 1987 to give Mexico the time it needs to adjust to the fall of petroleum prices.

--If no agreement is reached, the most likely measure would be a delay in interest payments.

Delay interest payments

--Anticipating an easier IMF program, President de la Madrid has ordered the new finance minister to prepare a revised economic plan emphasizing greater economic growth. The program could push inflation over 100 percent in 1986 and 300 percent by the end of 1987 as the government turns to expansionary monetary policy to finance the burgeoning budget deficit.

new growth?

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[redacted]

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Implications of a Foreign Debt Moratorium

US banks

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[redacted] US bankers believe they are in a better position to deal with a Mexican payments delay than they were in 1982.

--Although still vulnerable, most banks are in stronger financial shape because they have increased capital and built up reserves against potential bad loans.

--Some banks, particularly US regionals, already have written off or swapped a substantial portion of their Mexican debt.

We believe a payments moratorium, however, still would adversely affect the US banking community.

--US commercial bank exposure to Mexico is the largest to a third world country, $25.2 billion and is concentrated in the 24 largest US banks, which account for three-fourths of all loans.

$25.2 b

25X1

[redacted]

--Given the current regulatory environment, all US banks with exposure in Mexico would suffer earnings losses within six months. Several of the United States' largest banks, which have the heaviest exposure, could show negative profits.

In the event of a debt moratorium, some banks have indicated that they will retaliate against Mexico which could further complicate US/Mexican bilateral negotiations on other issues.

--Some banks plan to cut trade lines and interbank loan lines of credit.

--Others also may threaten to attach monetary and physical assets to pressure the Mexicans to clear all interest arrearages.

Over the near term, Mexico probably would benefit economically from a moratorium on foreign debt payments. A debt moratorium, [redacted] also probably would be politically popular.

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--The savings in interest payments--$9 billion annually--would give Mexico City sufficient liquidity to conduct foreign trade even if banks cut short-term credit lines to the government.

$9 b. interest/yr.

--Given the magnitude of the savings, we believe that de la Madrid probably could keep the economy afloat through the end of his term in 1988.

[redacted]

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--The onset of negative effects would depend largely on the level of public sector deficit spending and possible US actions to minimize the effect of the moratorium.

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